The Role of the Long Term Investors Club for the Exit Strategy

UnionEuro Bonds for Debt and Economic Recovery of Europe

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Abstract

In the middle of June the Kreditanstalt fuer Wiederaufbau (KfW) hosted a high level conference organized by the Long Term Investors Club in Berlin, an international private organization which includes the most important institutional investors worldwide.

The conference presented several plans of growth, taking at the same time a very firm position against the persistent tendency of the markets to short term financing, even after the devastating effects of the financial crisis, and against the generally accepted regulatory framework for financial institutions which are not in favour of long-term investments.

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ANALYSIS

In the middle of June the Kreditanstalt fuer Wiederaufbau (KfW) hosted a high level conference organized by the Long Term Investors Club in Berlin, an international private organization which includes the most important institutional investors worldwide.

The Ltic was created two years ago by four European state-connected financial and banking entities, the French Caisse des Depot et des Consignations, the Italian Cassa Depositi e Prestiti, the European Investments Bank and by the German KfW, with the aim to promote a return of the global economic actors back to investing in the modernization and in the development of the real economic sectors.

By now it encompasses 14 members, such as developments banks, sovereign wealth funds and pension funds representing a combined balance sheet of over 3.000 billion dollars.

The purpose is to assert a common identity as long term investors in order to create the conditions for greater cooperation and to give the message that long term investment will be a decisive element in ensuring international financial stability and sustainable economic growth.

Ltic will play an important role in responding to new international challenges, including financial and economic crises. It can constitute the main cooperation platform for implementing far reaching global objectives such as providing energy, building infrastructures, fighting climate change and developing new technologies.

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Presently potential long-term investors own assets of over 30.000 billions euros. So far only a very insignificant percentage goes into long-term real projects. The aim is to channel at least 5 - 7 % of this capitals into infrastructure investments. The Ltic can play a catalytic role in this process because it already combines a public-private partnership approach.

But these discussions and plans could be of great relevance to find solutions for the ongoing deep crisis of the financial and monetary role of the euro and for the future political identity of the European Union.

In the past weeks we have experienced strong speculative international attacks against the European currency and against the state bonds of some of the weaker European economies such as Greece, Ireland, Portugal, Spain and Italy. Later, all the European stock exchanges went through severe speculative attacks and suffered giant, and unjustified, losses. For too long time the EU institutions and several member states looked at these

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financial assaults as justifiable markets reactions to certain national economic weaknesses or excessive budget expenditure.

It is true that several mistakes and superficial economic attitudes were committed by a number of European governments, but Europe missed the significance of the present historical moment and of the ongoing economic processes. It did not want to immediately recognize that the real target was not primarily the Greek or the Italian bonds but the value and the role of the Euro and the structure of the European Union.

Some Europeans may have incompetently played with the illusion of a break up of the Union and with the return to the nation-states interests of the pre Maastricht period. Others spoke about a two-speed Europe, one for the good and strong countries and the other one for the weak and the bad.

They confused a compulsive dream with a real nightmare. It is very naïf to think to turn back the clock, as if it would be simply a mechanically linear exercise. A dissolution of the European Union will produce a devastating market collapse of all the European components, also of the strongest parts. Politically it will bring Europe back, not to a situation comparable to the Eighties or the Nineties, but it would catapult the old continent back into the Thirties with the old hostilities and the known egoisms.

These same Europeans did not want to realize that the attack against the euro and the European Union was not for their weakness but, on the contrary, for their strength and for their potential role in the future global geo political and geo economic arrangements.

The European Union represents the strongest industrial and technological part of the world economy with a GDP of around 10.000 billions euros. It is the world leader in the machine tools production; it has the most powerful and impressive network of high tech innovative Mittelstand (middle size enterprises) sector, which is the real motor for R&D and for new advanced technologies. It is the biggest, technologically modern market with over 500 million consumers and producers.

While the post war dollar dominance is fading away to be replaced by multi polar monetary arrangements, the Euro could become the most significant anchor of stability and a reference point also for the future role of the BRICS countries.

Europeans are still misinterpreting the ongoing economic and political processes unleashed by the recent global financial crisis.

First, we are not primarily experiencing a public debt crisis. We are still effected by the banking crisis and by the consequences of a wrongly conducted banking and financial bail out. To save the collapsing banking sector the United States officially injected 3.000 billion dollars of new liquidity and the European Union intervened with financial aid of around 2.000 billion euros. Additionally, the world economy experienced a significant down turn in trade and production. This has produced an average increase of about 20% in public debt in the Western countries.

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Clearly such process has strongly hit the European economy. The immediate result was a deep further destabilization of the balance sheets of the weakest European countries.

At the same time the above mentioned new liquidity was injected without any significant control in a system always operating without new rules and orientation. The much discussed global financial reform has thus far been on paper only.

As I documented on several occasions, the financial sectors strengthened by this new liquidity supply, went back to its old short term speculative behaviour. We had continuous waves of speculation on the commodities markets. We had in a similar way speculative assaults on the euro system.

Reflecting the lack of European will for a strong political union, also the European press has psychologically submitted itself to the power of the rating agencies, whose daily downgrading of the European bonds are presented as the new gospel.

It creates a very strange feeling to see Europe and the European leaders submitted to the will of the financial markets, desperately trying to please these new gods of Olympus. These markets are given the ultimate and utmost authority. The very same financial markets were saved by the European and American Governments by there intervention. Fortunately, some leaders are beginning to recognize Europe's strength and are planning to confront the concerted speculative actions against the Euro.

In this difficult context the Ltic and in particular its European components are presenting some very valuable ideas and proposals. While the implementation of a rigorous review of the budget spending at a European level is crucial, it is even more clear and important to recognize that the fiscal measures alone will not suffice in reconstructing economic confidence and stability. The fundamental challenge Europe is facing is called joint economic recovery and growth both in the centres as well in the peripheries.

Here comes the proposal for **European project bonds**. They would be a form of European debt oriented to finance investments in fixed capital projects of EU strategic importance in infrastructure, energy, and telecommunication. The debt to build such works would have the public "insurance" of Europe, but structured as project financing to attract also the participation of private capital. It will be repaid by the capability of the projects to generate significant cash flows and thus it will not burden the public budgets.

Today the public budgets are under stress. This requires finding new financial instruments to attract private capital and long term savings, to replace decreasing public investments. It is a mechanism of credit enhancement based on a guarantee and on tranches of debt subordinated to a credit and quality control.

For Europe alone the European Commission and the World Bank calculate that new investments of around 3.000 billions euros in the processes of modernization of the energy and transportation sectors are required. This includes the realization of the TEN-T (transportation) and the 20-20-20 projects (20 % renewable energy, 20 % less CO_2, 20 % more energy efficiency by the year 2020).

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Realizing this project bond approach will require a new bond market regulation, a new technical structure by the EU Commission or by the European Investments Bank to evaluate the technological quality of the projects and the creation of a new Agency to control and to assure the liquidity movements.

The second proposal presented by some members of the Ltic is the creation of a **Euro bond**. Such ideas have also been supported in the recent past by several European government representatives. It has been opposed by others who believe that such policy could give free hand for future debt and new public financial hazards.

In reality the positive effects outnumber the downside risks. The simple decision to launch euro bonds will stop the ongoing speculative attacks. They will signal that from now on the markets and the speculators will have to face the entire economic and political strength of Europe. It could at the same time introduce new rules to curb short term speculative operations.

They could become a natural evolution of the European Stability Fund. Each Eu state member could issue euro bond equivalent of 40 % to a maximum 60 % of its own GDP of the existing public debt (this is the maximum debt quota required by the Maastricht Treaty) to replace the old national bonds. These titles would be jointly guaranteed by all the Eu members through a Fund of equivalent dimensions. The immediate effect would be a better rating standard and a decrease of the average European interest rates.

The remaining public debt will be the responsibility of the individual States and would be subjected to a coordinated and collectively decided restructuring process under conditions of a policy of fiscal adjustments. A European Debt Agency could replace the Stability Fund and could issue new debt titles of each EU member country. It could also intervene and buy titles of countries under stress to reduce their interest costs bringing them down to the average European interest rates.

As part of the restructuring process, private owners of debt titles could ask to swap them for other titles issued by the European Debt Agency. This would reduce the pressure on the value of the debt bonds because in this way they could be negotiate on the markets at a levels close to their nominal values and not at a very depreciated level, as it happens currently.

Along the same line, former EU Commission President, Romano Prodi, together with Economics professor Alberto Quadrio Curzio of the Milan Catholic University, recently presented a very important proposal for what they call **EuroUnion Bonds**. They proposed the creation of the European Financial Fund with a basic capital of 1.000 billion euros. The capital would be formed by the 350 millions ounces of gold presently hold in the central banks of the European states for a total value of about 450 billion euros. The rest would be formed by the industrial shares and bonds held by the European governments in private sectors such as energy, oil, gas, telecommunication, postal services, etc. The quotas would be divided applying the same proportions valid for the European Central Bank. Germany would participate with 270 billions euros, 140 of which coming from its gold reserves and France with 200 billions, half of which in gold. Italy would contribute with 180 billions euros, of which 100 from the gold reserves. The other countries will follow in the said proportion.

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Using a moderate leverage of one to three, the Fund would issue bonds for 3.000 euros. To bring the average European debt/gdp from the present 86% to the level of 60 %, 2.300 billions euros bonds would be needed. The remaining 700 billions euros would be used to promote long term investments in basic infrastructure, energy, transportation and technological modernization.

Gold and state participations in the shares of private companies would not be sold, as many wrongly propose as the only way to reduce the sovereign debts, but used as capital for the Fund. This would avoid linear budget cuts and other austerity measures which will have devastating recessive and negative social effects.

While the global financial crisis will not leave us till a new Bretton Woods of rules and programs is globally agreed, Europe is called upon to face some major challenges. First of all Europe would have to find and to define its political will to build a long-waited united political and economic architecture for the old continent.

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Remarks: *Opinions expressed in this contribution are those of the author.*

About the Author of this Issue

Paolo Raimondi (1950), Rome, Italy. Economist. Studied at the "Bocconi" University of Economics in Milan. Expert in international finance. Economic consultant in areas like Russia, Kazakhstan, Brazil, Sub-Sahara Africa. Analyst in economic research centres. Since 1995 collaborated with members of the Italian Parliament on initiatives to curb financial speculation, tax evasion and on matters related to global financial and monetary reforms. 2006 - 2009 chairman of the "Equitalia Frosinone", a tax regional entity controlled by the Italian Finance Ministry. Since 2007 editorialist of the Italian economic daily "ItaliaOggi". Writes international economic analyses for other Italian dailies like, "La Gazzetta del Mezzogiorno", "Europa" and for specialized economic magazines, like "La Finanza". Author of books, "I gattopardi di Wall Street", 2010 written together with Mario Lettieri, undersecretary of Economics in the last Prodi's government.

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